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SUBJECT: SOUTH AFRICA ECONOMIC NEWSLETTER FEBRUARY 24 2006
ISSUE

¶1. Summary. Each week, Embassy Pretoria publishes an economic newsletter based on South African press reports. Comments and analysis do not necessarily reflect the opinion of the U.S. Government. Topics of this week's newsletter are:

- January Consumer Prices Continue Their Muted Rise;
- Producer Prices Increase 5.5%;
- Power Outages in Western Cape Province;
- Crisis Team to Manage Cape Power Outages;
- South Africa and United Arab Emirates Exchange Skills;
- Proposed Moratorium of Land Sales to Foreigners No Problem to Investors; and
- Provincial Capital Spending Expected to Improve.

End Summary.

January Consumer Prices Continue Their Muted Rise

¶2. Consumer prices (CPI) and consumer prices excluding mortgage costs (CPIX) increased 4% and 4.3% in January, in line with market consensus forecasts of 4% and 4.4%, respectively. January's inflation came in higher than December's CPI and CPIX inflation of 3.6% and 4%, respectively, primarily due to increasing food and medical services prices. Core inflation, which excludes items with volatile prices, such fuel and certain types of fresh and frozen food, rose to 4.1% from 3.7% in December. With CPIX inflation still below the midpoint of the South African Reserve Bank's 3-6% target range, most analysts expect no change in interest rates during 2006. In his annual budget speech, Finance Minister Trevor Manuel expected CPIX inflation to average 4.5% over the next three years. It has remained inside its target range for 29 consecutive months. January typically shows higher inflation because some components included in the consumer price indices are surveyed annually rather than every month. Specifically, annual surveys updated inflation for housing (including rent) and medical care and health expenses (including doctors' and hospital fees and contributions to medical insurance). On a monthly basis, price inflation of health care and food contributed 0.3 and 0.4 percentage points, respectively, to January's 0.7% change. January's gasoline increase of 4 rand cents per liter did not influence CPIX inflation much, although February's 14 rand cent increase will put some pressure on February's inflation. In addition, continued rand strength will dampen imported price inflation, helping to contain inflation. Source: Reuters, Standard Bank, CPI Alert and Investec CPIX Update, February 22; Business Day,

February 23.

¶3. Comment. Over the last few years, prices of non-tradable goods were the major sources of South African inflation. Between 2003 and 2005, education, tobacco, health expenses, household operations and transport costs posted the highest inflation. Prices of clothing and footwear, furniture and equipment along with recreation and entertainment declined over the same period. Imports are highest in these industries as competition from low-cost countries and the strong rand contained imported inflation. End comment.

Producer Prices Increase 5.5%

¶4. January producer prices increased by 5.5% (y/y) from December's inflation of 5.1% lower than market expectations of 5.9%. Higher inflation in petroleum products and coal, basic metals, and agriculture and processed food contributed to January's higher annual rate of inflation. On a monthly basis, food prices declined, due to lower fruit and vegetable prices. As a result of a stronger trade-weighted rand, inflation in imported producer goods in January subsided slightly while domestic producer prices increased. In January, domestic and imported producer prices increased 5.2% and 6.4% compared to December's 4.6% and 6.5%, respectively. Source: Standard Bank, PPI Alert; Investec, PPI Update, Statistics SA Release P0142.1; February 23.

Power Outages in Western Cape Province

¶5. Large portions of the Western Cape experienced power outages during February 19 and 20, with continuing intermittent power cuts expected throughout the week in order to avert wide-scale blackouts. During the weekend, power outages affected mostly residential users, although commercial and industrial consumers faced outages on February 22. Eskom has advised that Cape Town will have to do without 500 megawatts (mW) of its normal weekday consumption of 2600mW, according to Saleem Mowzer, chief executive of the Regional Electricity Distributor. Mowzer said power cuts would continue until the weekend of February 25-26, with the situation normalizing once the Koeberg nuclear power station was working optimally. The Western Cape region is dependent on Koeberg and overland power transmission lines for electricity supply. Analysts attribute erratic electricity supply to years of underinvestment on ageing infrastructure that cannot provide enough power to a growing economy. Eskom announced plans to pour R93 billion ($15.5 billion, using 6 rands per dollar) into creating new capacity over five years, including restarting mothballed coal plants and building gas-fired facilities and a pebble bed nuclear reactor. About 90% of South Africa's power comes from coal, and 6% from Koeberg, Africa's only nuclear facility. Eskom will increase electricity prices in 2006 by 5.1%, followed by 5.9% and 6.2% in 2007 and 2008, respectively, all above expected inflation rates. Source: SAPA, Business Report, Business Day, and Reuters, February 22.

Crisis Team to Manage Cape Power Outages

¶6. A crisis committee will manage rolling blackouts in the Western Cape Province as power cuts affect commercial and industrial users as well as residential consumers. Consisting of Eskom, the Cape Town City Council, the Regional Electricity Distributor One (Red One) and the provincial government, the committee will try to minimize adverse economic effects of the rolling blackouts. Eskom announced the power cuts would last an extra two days past

its previous assurance that full power would be restored by February 21. Eskom CEO Thulani Gcabashe said the power cuts were being extended because work to get Koeberg's nuclear plant up and running had taken longer than expected. Saleem Mowzer, head of newly created Red One said the distributor would be spending R180 million ($30 million) in 2006 on improving infrastructure. Source: Business Day, February 23.

South Africa and United Arab Emirates Exchange Skills
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¶7. As part of the Accelerated and Shared Growth Initiative, the South African government announced a placement and exchange program with the United Arab Emirates (UAE). The program will choose 100 women to work for companies in the UAE to develop their skills. The women would work in the construction, banking and hospitality industries. Primarily, recently graduated unemployed professionals, experienced women contractors and business owners will be recruited for exchange. The government cites shortages of skills as a major constraint to creating more jobs and increasing the long term growth to 6%. Source: Business Day, February 23.

Proposed Moratorium of Land Sales to Foreigners No Problem to Investors
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¶8. Shadrack Gutto, the chairman of the government-established panel of Experts on Foreign Ownership of Land, asserted that the panel's proposed recommendation of a moratorium on land sales to foreigners would not impact foreign investors. He cited studies from Chile, Brazil, and Canada showing that controls on foreign land ownership did not affect investor confidence as evidence of investor's unconcern in domestic land sales procedures. According to Gutto, foreigners sell after several years, while investors are interested in security of tenure. The panel recommended a halt in land sales to foreigners as an interim measure until the Department of Agriculture and Land Affairs formulated new legislation. It also recommended new disclosure requirements applicable to both corporations and individuals owning land. Individuals

would be required to disclose gender, nationality, and citizenship. Gutto states that the panel is still considering whether disclosure of race will be required. Agriculture and Land Affairs Minister Thoko Didiza should receive the panel's final report either in April or May
¶2006. The Cabinet will have to accept the panel's recommendations before implementation. Source: Business Day, February 23.

Provincial Capital Spending Expected to Improve
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¶9. Finance Minister Trevor Manuel expects provincial under spending on capital projects to reach R800 million ($133 million) during the current fiscal year. During the 2004/05 fiscal year, provincial governments failed to spend nearly R2 billion ($314 million at R6.36 per dollar, the average 2005 exchange rate) of their R12 billion ($1.9 billion) total capital budget. Manuel noted that R1.2 billion more had been spent on capital projects compared to the previous fiscal year. He cited improved communication between the Departments of Education, Health and Public Works as key to increasing provincial capital spending. The Division of Revenue Bill, determining the split of funding between national, provincial and local governments provides for 51% national share (R215 billion or $35.8 billion of the R418.2 billion capital budget for 2006/07), 42% going to the provinces (R176.7 billion, or $29.5 billion) and 6% (26.5 billion, or $4.4 billion) allocated to municipalities. Critics pointed to third

quarter 2005 figures showing that provinces spent only 55% of their capital budget, as indications that provinces may not be able to fully utilize this fiscal year's capital budgets as much as Manuel expects. Source: Business Day, February 20.

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